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Pay For Performance, And Nothing Else

Employment relationships are transactional by nature. Today's transactions are fast moving, short-term and fully exposed, as free agents negotiate with managers for project and contract work.

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If you are really serious about moving into the new economy and winning the talent wars, stop paying people and start buying their results.

It's a simple idea: Employment relationships are transactional by nature. They always have been. But instead of being slow moving, long-term camouflaged transactions, as they were in the workplace of the past, now the transactions are fast moving, short-term and fully exposed. Free agents are negotiating with managers every day and they are driving a hard bargain.

Pay Market Value

Paying people the market value of their work – whatever the market value is today – is precisely how you can get yourself and your company out of bidding contests that don't work and into bidding contests that do.

Short-term pay-for-performance contracts will be the natural culmination of the free market for talent, and therefore, the norm of employment in the new economy. They are also the best way to give free agents exactly what they want – to be paid what they are worth when they deliver – without breaking the bank.

An ongoing research study at the Wharton School of Business demonstrates that short-term, results-based work relationships often create a higher level of commitment than long-term relationships. The researchers believe this is because the short-term contracts give participants a very clear idea of what's expected of them, what they'll gain from delivering, the time limits of the job and the work load necessary to complete it successfully within that time period.

Managers simply must start establishing clear deliverables and deadlines with every employee every step of the way, agree on fair prices in financial and non-financial compensation for every milestone, and then start paying vendors of talent (formerly known as employees) when they deliver, and only when they deliver. This is also going to short-circuit your performance evaluation system – the only evaluation necessary will be the ongoing review of deliverables at every milestone and the daily performance coaching along the way.

Reward Most Valuable Players

By now, of course, there are plenty of adherents to team-based rewards. How such a plan is administered, of course, depends on what performance a company is trying to incentivize.

If you are trying to incentivize profitability, share profits: Asea Brown Boveri (ABB), the innovative power engineering company based in Switzerland that employs more than 200,000 people, is split into 1,200 different companies with roughly 200 employees each. Each company within ABB is accountable for its own profit and loss, and keeps a third of its net profits.

If you want alacrity, pay for it: Continental Airlines CEO Gordon Bethune got a lot of press for turning the company around from bankruptcy largely using a company-wide pay-for-performance initiative. Because the company was losing \$6 million a month due to late arrivals, Bethune set up a bonus system where every employee got \$65 (half the \$6 million divided by the number of employees) for every month Continental was in the top five airlines for on-time arrivals. Within three months, Continental rose from #7 to the #1 spot. Now the \$65 is awarded to every employee every month at least 80% of flights are on-time. As of April 2000, 41 on-time bonus payments have been made to Continental staff, with total bonus payments reaching \$124 million.

How do you reward something intangible like "good customer service"? Ask your customers if they are happy: Metamor Technologies, the \$600-million-a-year IT company regularly surveys a random sample of clients. Riding on the answers: 10% of consultants' salaries and 40% of bonuses.

Great stories. Right? But you have to be very careful with team-based rewards. What about the ABB engineer who works twice as hard as the next guy? And the Continental Airlines pilot who shows up early for every flight and works closely with the maintenance crew to check out the plane before it is time to go, while the other pilots don't? And the Metamor Technologies consultant who is so much smarter and more effective than the others, she makes up for the less impressive consultants, resulting in satisfied client reports in the phone survey?

Rewarding Star Performers

What about the star performers? Imagine a team of five people on which two members do 80% of the work, one member does 20% of the work, and two of the people just show up for the meetings. People in my seminars describe this scenario to me every day. And they are absolutely right to complain that it is profoundly unfair to reward everybody on such a team equally. If you do so, the superstars will feel burned while the low performers are rewarded for work they didn't do.

Those who perform the best work at the fastest pace should get the most rewards. In a recent survey of 770 major North American companies, researchers at Towers Perrin found that the best-performing companies (those in the upper quartile of shareholder returns) pay their high performers significantly more—in financial and non-financial rewards—than other employees.

Even at Cisco Systems, so well known for its "one company" culture, makes employee stock options contingent upon individual performance measures. Given the skyrocketing success of Cisco, the leading developer of "network plumbing for the Internet," which is now the world's most valuable company in terms of market capitalization, the approach is obviously working.

Ultimately if a reward system is fair, in market terms, it will provide real incentives for performance and create the kind of cohesiveness that comes from a team of high performers playing their individual roles to the best of their abilities.

Bruce Tulgan is the author of *Winning The Talent Wars* (WW Norton, 2001) and *Managing Generation X* (2nd Edition: WW Norton, 2000; first published by Merritt in 1995). He is founder of RainmakerThinking, a research and consulting firm in New Haven, CT. This article adapted from chapter 4 of *Winning the Talent Wars*.

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